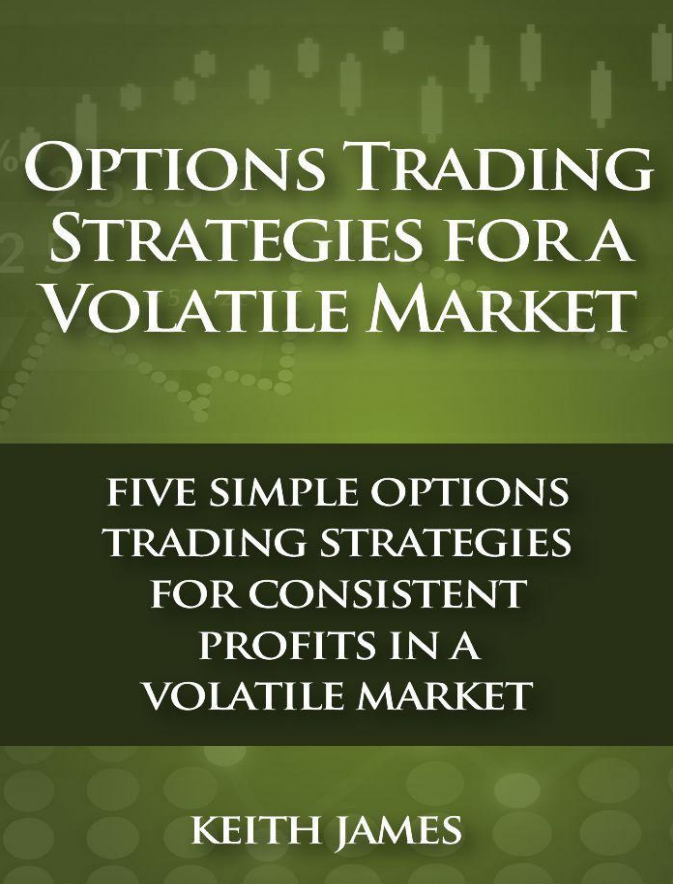


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OPTIONS TRADING STRATEGIES FOR A VOLATILE MARKET

FIVE SIMPLE OPTIONS
TRADING STRATEGIES
FOR CONSISTENT
PROFITS IN A
VOLATILE MARKET

KEITH JAMES

Options Trading Strategies for a Volatile Market

Five Simple Options
Trading Strategies for
Consistent Profits in a
Volatile Market

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Introduction

I want to thank you very much and congratulate you for downloading the book, *Options Trading Strategies for a Volatile Market—Five Simple Options Trading Strategies for Consistent Profits in a Volatile Market*

The goal of this book is to help people who are already familiar with option terminology and the basics of how the options market works.

In this book, you'll discover the five best options trading strategies for a volatile market. For each strategy, you'll

learn how it works, the best times to use it, the risk and reward dynamics, and you'll be taken step-by-step through complete examples.

Thanks again for downloading this book, I hope you enjoy it!

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Chapter 1 – Overview

This guide is to help people who are already familiar with option terminology and the basics of how the options market work. It is designed to give you an overview of the main strategies for using options when the market conditions are volatile.

Making money in a volatile market is risky as a volatile market means that prices can rise and fall dramatically. This is significantly different to a bearish or bullish market as your strategies have to be able to profit when

the price of the underlying asset moves by a significant amount in either direction, and not just in one.

The reason that options are held in such high regard by professional traders is that you can set up strategies that allow you to make a profit regardless of whether the price of the underlying asset moves up or down, as long as it does so by a significant amount. Large price movements are not the only kind of volatility that you need to consider when talking about a volatile option markets though.

As an experienced option trader you should already be familiar with the

Greeks, and know that the Vega shows the implied volatility of an option contract. A change in implied volatility can have a dramatic effect on the cost or premium of the option, and you always need to be aware of implied volatility for this reason. Therefore a volatile option market can be when prices jump quickly or when the implied volatility is increasing.

It is important to note that although implied volatility should increase when there is a major news event affecting the underlying asset, and decrease when the market is quiet. It is possible for implied volatility to change without any obvious reason. This is due to a shift in

the market perception of what the implied volatility should be, rather than from any factual cause. Implied volatility will increase with demand for a particular option, and decrease if demand is low.

Chapter 2 – Basics of Volatile Option Strategies

The basic theory behind constructing an effective strategy for a volatile market is to take advantage of duo-directional profits. What this mean in its simplest form is that you are setting up positions that are made up of two parts. The first part is to set up a trade that will gain more than it will lose when the price of the underlying assets rises, and the second part does the opposite. This means that it will gain more from the rapid decline in the value of an option than it will lose.

The simplest version of this is to use a combination of long calls and long puts in the hope that the change in the price of the option due to high volatility will push one of these two trades into enough profit to cover the cost of the one that is going to be out of the money. More complex strategies for volatile markets work by combining bullish and bearish option strategies in a way that will accomplish much the same thing. When setting up a volatile option strategy the thing that you want to look for is a high Gamma value with a neutral or almost neutral Delta value.

A good time to implement a volatile option strategy is when there is a

potential increase in the implied volatility on the market, even if the prices have not yet started to move. This will set you up for success at the lowest possible cost, and will occur when the strategy that you are considering implementing has a positive Vega value. Just by having a positive Vega value if everything else stays the same, the position you have selected should make a profit.

Evaluate your volatile option strategies in periods before earnings release statements, or other key financial information about a company or the market as a whole. Volatility across the market tends to increase during these

periods. As soon as you see that implied volatility has stopped increasing and has reached its peak, then you should close the strategy. There is a volatility measurement index called VIX that a lot of traders use to track implied volatility and decide when volatility is increasing or has peaked.

Chapter 3 – Account Trading Levels

It is important to understand the account trading levels that apply for option trading accounts. Some of the strategies in this guide require higher trading levels than others. Often referred to as your ‘trading’ or ‘approval’ level, it is set by your broker based on your net worth, and your level of experience in trading options.

In most cases, when you first open an option account you will be given a level of 1. You will need a higher level than that to implement the trading strategies in

this guide, so you need to contact your broker and discuss what you are looking to do, and what he needs from you in order to get the approval you need.

Level 1 allows you to trade covered calls and protected puts. This means that you need to own the underlying asset and is not much use for trading options. At level 2 you are able to buy call and put options. You are not able to use debit spread strategies until your approval level has reached level 3. You cannot utilize credit option strategies yet, as this is at level 4. Level 4 will also allow you to trade short butterfly spreads.

The reason that the approval level is so

high is that credit strategies are complex and require a lot of experience to know exactly what your profit or loss can be. Level 5 is the highest level and usually reserved for institutional traders as you can write call and put options without owning the underlying asset. This is extremely dangerous as you are exposed to a very high risk.

Chapter 4 – Long Straddle

This is one of the most straightforward of all of the volatile option strategies, and allows you to make a profit whether the value of your option contracts increases or decreases, as long as it does so significantly. This means that the best time to employ a Long Straddle is when you expect the value of an underlying asset to suddenly move either up or down very quickly. The usual reason why the value of an underlying asset will do this is often a major news event.

Setting up a long straddle is very simple

and can be executed very quickly. What you need to do is to execute an at the money call and an at the money put at the same time, for the same underlying asset, expiring at the same time, and as far away as you can get. The potential profit is unlimited as if the value of the underlying asset rises sharply, then you will make a profit on the call less the cost of the two premiums. Similarly if the value of the underlying asset sharply drops in value you will make unlimited potential profit on the put that you purchased, less the cost of the two premiums.

Example

An example would be if you expected the price of ABC Company is going to suddenly move significantly but are unsure whether it will be up or down and the current value of the stock is at \$25. You would want to buy a call option with a strike price of as close to \$25 as you can find, and a put option with the same strike price. If you think the movement is going to occur within the next month then you would buy both of these options with the same expiry and at least one month to left.

Assuming the premium on each at the

money option is approximately the same, say \$1 for this example, then your total cost to set up this trade will be $\$1 + \$1 = \$2$ times 100 shares in the option contract so \$200. If you are correct and ABC company gets great news and the price rises from \$25 a share to \$30 a share, then you will make a profit of $\$5 * 100 \text{ shares} = \500 less the premium cost of \$200 = \$300. If the price had dropped by the same amount from \$25 to \$20 then your profit would be the same.

In addition to these two profit alternative there is a third one, where the implied volatility of the underlying asset rises, while you are holding the two options even though the price of the underlying

asset does not change, then the value of both of your option positions will still rise, and you will make a profit if you close them when the implied volatility peaks. If none of these situations occur before expiry you will lose both premium payments.

Chapter 5 – Strap Straddle

You should use a Strap Saddle when you expect the value of underlying asset to move suddenly and that the move is more likely to be up than down. To set it up, you buy more call than put options. Considering you believe that the value is more likely to rise than drop, then you would buy two at the money calls and one at the money put at the same time, for the same underlying asset, expiring at the same time and as far away as you can get.

If you are right then you will make double the money when it rises, less the cost of three premiums. If you are wrong, and the value falls significantly, then you will still make a profit on the put, less the cost of the three premiums.

Example

An example would be if you expected the price of ABC Company is going to suddenly move significantly and you think but are not it will be up, and the current value of the stock is at \$25. You would want to buy 2 call options with a strike price of as close to \$25 as you can find, and a put option with the same strike price.

Assuming the premium on each at the money option is approximately the same, say \$1 for this example, then your total cost to set up this trade will be $\$1 + \$1 + \$1 = \3 times 100 shares so \$300. If

you are correct and ABC company gets great news and the price rises from \$25 a share to \$30 a share, then you will make a profit of $\$5 * 100 \text{ shares} = \500 times two option contracts so \$1000, less the premium cost of \$300 = \$700. If the price had dropped by the same amount from \$25 to \$20 then you would make \$500 less \$300 so \$200.

Chapter 6 – Long Strangle

This is similar to the long saddle but is less expensive and is also one of the most straightforward volatile option strategies. It requires trading level 2 and allows you to make a profit whether the value of your option contracts increases or decreases, as long as it does so significantly. This means that the best time to employ a long strangle is when you expect the value of an underlying asset to suddenly move either up or down very quickly. The usual reason why the value of an underlying

asset will do this is a major announcement.

The issue with the long strangle is that the price of the underlying asset or the change in implied volatility, needs to be higher than it does in a straddle to make a profit. On the other hand if the value of the underlying asset does move significantly as you expect then you will make a bigger percentage profit than you can with the long straddle

In order to set up the long strangle you need to do is to execute an out of the money call and an out of the money put at the same time, for the same underlying asset, expiring at the same time. The

potential profit is unlimited as if the value of the underlying asset rises sharply, then you will make a profit on the call less the cost of the two premiums. Similarly if the value of the underlying asset sharply drops in value you will make unlimited potential profit on the put that you purchased less the cost of the two premiums.

Example

As you are working with out of the money options, the premium will be a lot lower as the risk of neither of them going into the money is greater. For example if the stock price of ABC company is at \$25 and you expect it to move by \$5 in the next month, you would buy and out of the money call option with a strike price of \$26 and a premium of \$0.25 and an out of the money put option with a strike price of \$24 with a premium of \$0.25. Your total premium cost is then \$0.5 times 100 so \$50.

If the price moves up to \$30 then your

profit is new price less the strike price so $\$30 - \$26 = \$4$ times $100 = \$400$ less the premium of $\$50 = \350 profit. The profit is not that much higher but the return on investment is significantly greater as you are only risking $\$50$ and making $\$350$ instead of risking $\$200$ with a long straddle and making $\$300$.

Chapter 7 – Strip Strangle

You should use a strip strangle when you are feeling bearish about a volatile underlying asset but are uncertain that you are right, and you still want to make a profit if the volatility is in the opposite direction than you expect. To set it up, you buy more out of the money put options than call options. Considering you believe that the value is more likely to fall than rise, then you would buy two out of the money puts and one out of the money call.

If you are right then you will make double the money when it suddenly drops in value, less the cost of three premiums. If you are wrong, and the value goes the other way instead, then you will still make a profit on the call, less the cost of the three premiums.

Example

An example would be if you expected the price of ABC Company is going to suddenly move and you think it will more likely be down, and the current value of the stock is at \$25. You would want to buy 2 put options with a strike price of \$24 and a call option with a strike price of \$26.

Assuming the premium on each at the money option is approximately the same, say \$0.50 for this example, then your total cost to set up this trade will be \$1.50 times 100 shares so \$150. If you are correct and ABC company gets bad

news and the price falls from \$25 a share to \$20 a share, then you will make a profit of $\$4 * 100 \text{ shares} = \400 times two option contracts so \$800, less the premium cost of \$150 = \$650. If the price had risen by the same amount from \$25 to \$30 then you would make $\$400 - \150 so \$250.

Chapter 8 – The Long Gut

This is similar to the long straddle but is more expensive. It requires trading account level 2, and allows you to make a profit whether the value of your option contracts increases or decreases as long as it does so significantly. The long gut uses in the money options, rather than at the money options, which means that the premium cost will be higher. The advantage of it is that it is easier to find in the money options to construct the trade that it is to find at the money options. There is also less risk that you

will lose your entire premium as both of the premiums that have paid are in the money at the time of purchase.

In order to set up the long gut you need to do is to execute an in the money call and an in the money put at the same time, for the same underlying asset, expiring at the same time. If the value of the underlying asset rises sharply, then you will make a profit on the call less the cost of the two premiums. Similarly if the value of the underlying asset sharply drops in value you will make a profit on the put that you purchased less the cost of the two premiums.

Example

For example if the stock price of ABC company is at \$25 and you expect it to move by \$5 in the next month, you would buy an in the money call option with a strike price of \$24 and a premium of \$2 and an in the money put option with a strike price of \$26 with a premium of \$2. Your total premium cost is then \$4 times 100 so \$400. If the price moves up to \$30 then your profit is new price less the strike price so $\$30 - \$24 = \$6$ times 100 = \$600 less the premium of \$400 = \$200 profit.

The profit is lower and the return on

investment is significantly lower but your risk of losing the entire \$400 is also consequently much lower. You will also make a bigger profit by a change in implied volatility, and the amount of the change can be relatively low. If the price of the underlying asset starts to rise then you can close the in the money put option and just leave the call option open and vice versa if the underlying asset value starts to fall.

Chapter 9 – Final Notes

While these option strategies are quite similar they are also significantly different, as they depend on your view point, and the level of risk that you are willing to take. As you can see from the examples you can either balance your risk so that you have an equal chance if the value of the underlying has a huge move up or down, or you can position yourself on one side or the other, while at the same time making a profit if you are incorrect. By working with these strategies you will quickly become adept

at making a profit in volatile markets.

Conclusion

Thank you again for downloading this book!

You should now have the knowledge you need to get started trading using these options trading strategies for a volatile market.

The next step is to take action!

Finally, if you enjoyed this book, please take the time to share your thoughts and post a review on Amazon. It'd be

greatly appreciated!

Thank you and good luck!

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